No. 22366

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

METROPOLITAN SAVINGS AND LOAN ASSOCIATION, a corporation, and FIDELITY SERVICE CORPORATION, a corporation,

Appellants,

vs.

WILLIAMS CONSTRUCTION CO., a corporation, and A. J. BUMB, Receiver,

Appellees.

APPELLEES' BRIEF.

GOLDMAN, GOLDMAN & ARNOLD,
By LEONARD A. GOLDMAN,
408 South Spring Street,
Los Angeles, Calif. 90013,
Attorneys for Appellee
A. J. Bumb, Receiver.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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APPELLEES' BRIEF.

I.

STATEMENT OF JURISDICTION.

This is an appeal from a decision of the United States District Court for the Central District of California (hereinafter called "the Court below") on review, pursuant to 11 U.S.C.A. §67(c), of orders of a Referee in Bankruptcy. The Court below had jurisdiction pursuant to 28 U.S.C.A. §1334 which provides that

> "District Courts shall have original jurisdiction . . . of all matters and proceedings in bankruptcy."

Jurisdiction over the instant appeal is conferred upon this Court by 11 U.S.C.A. §47 which provides that Courts of Appeal

> "are invested with appellate jurisdiction from the several courts of bankruptcy in their respective

> jurisdiction in proceedings in bankruptcy, either interlocutory or final, and in controversies arising in proceedings in bankruptcy, to review, affirm, revise or reverse, both in matters of law and in matters of fact . . ."

The Appellees herein wish to have this Court affirm the decision of the Court below which affirms certain orders of the Referee in Bankruptcy.

II.
STATEMENT OF THE CASE.

Appellee, Williams Construction Co., a corporation, is a debtor in a proceeding in the Bankruptcy Court under Chapter XI of the Bankruptcy Act. Appellee A. J. Bumb is the duly appointed and qualified receiver of Williams Construction Co., in the Bankruptcy proceedings.

Williams Construction Co., is a land developer having acquired the tract in 1963 that is in question on this appeal. Williams subdivided the property into 129 lots, of which 20 have been sold. The remaining lots owned by Williams consist of 109 lots. The sales prices of the lots that have been sold range between the sum of $12,500.00 and $15,000.00.

Williams fully improved the lots in question. The lots overlook a fully developed golf course and are quality lots. They range in elevation from 590 feet to 720 feet. The lots are within a mile of the extension of the Pomona Freeway and within a mile and a half of a shopping center. All of the streets in the tract have been paved, the curbs and gutters put in, and the underground utilities installed. The area is zoned for single family residential use [R-I-8500].

The highest and best use of lots owned by Williams is for single family residence use which is consistent with the general development and zoning of the area. The size of the lots varies between 8,500 square feet and 14,400 square feet. The lots present an interesting variation of approach, shape, elevation, views, and probable development. At least nine of the lots previously owned and sold have been fully improved with residences. The tract is located in the unincorporated community of Walnut Valley in the Southeast portion ot the San Gabriel Valley in Los Angeles County and is south and adjacent to Fifth Avenue about 1500 feet west of Brea Canyon Cut Off. The exact tract number is 28140.

The property was appraised by the estate's appraiser, Sam Jonas, for the total sum of $1,362,500.00 on September 30, 1966 which works out to an average of $12,500.00 per lot [See R. T. p. 15, line 24]. The appellant's appraiser, Taylor Dark of Marshall and Stevens Company testified that the selling price of lots today would be $13,500.00 on an average [See R. T. p. 269, lines 2-18]. Dark also testified that the fair market value, if the lots were sold individually, would be $1,200,000.00 plus [See R. T. p. 359, lines 22-23]. The owner, Herald Williams, President of Williams Construction Co., testified that the property was higher in value than $12,500.00 per lot, to wit, $14,000.00 to $16,000.00 per lot [See R. T. p. 149, lines 3-4]. The Appellant had no other expert testify on value who qualified as such expert. The equity of the Appellees was the sum of $366,183.00.

The Referee stated the definition of fair market value acceptable to this proceeding when he said

> "(The definition by the United States Supreme Court is) the amount in cash that in all probability would be arrived at by fair negotiation between an owner willing to sell and a purchaser willing to buy given a reasonable time to negotiate." [R. T. p. 393, lines 2-9].

The Referee granted the restraining order by order filed on November 23, 1966. The Receiver and Debtor brought on an Application to Transfer Lien of the Appellants to the Proceeds which was heard on November 28, 1966, and an order was granted to the Receiver and the Debtor dated January 17, 1967. The Referee in granting the order transferring the lien to the proceeds stated

> "That (Metropolitan Savings) will receive the lion's share (of sales proceeds), but I am going to permit the Receiver in this case to keep a small amount of what is received from those individual sales merely to cover the administrative costs of these proceedings; possibly five per cent, certainly not more than ten per cent in any sale until there has been enough of this property sold to put your client in a position where the default has been cured." [See R. T. p. 14, lines 8-17 of November 28, 1966 hearing].

The two orders were consolidated for review and a Memorandum Opinion dated September 18, 1967, and Supplement to Memorandum dated September 22, 1967, were entered by the District Court Judge. These matters are here upon appeal.

III.

SUMMARY OF ISSUES AND ARGUMENT.

In connection with the two orders of the Referee which are being appealed from, there are the following issues:

One, Are the Referee's rulings clearly erroneous?
Two, Is there an equity in the property in question?
Three, Does the Bankruptcy Court have the power to sell the property free and clear of the Appellant's lien?

Four, Does the Court have the right to substitute for the remedy of foreclosure the remedy of selling the property on a lot by lot basis?

In connection with these four issues, this Appellee summarizes the argument as follows:

One, The Referee's findings and rulings thereon are not clearly erroneous and should be affirmed upon this appeal. The record clearly shows that the findings of the Referee and the orders thereon have sufficient facts in the record to back-up said orders.

Two, The Referee's findings of equity in the subject property should be affirmed upon review. The record also clearly shows that there is an equity in this property for the benefit of this debtor and the Appellee. There is no evidence to the contrary to show that the equity of $360,000.00 is any less.

Three, The Bankruptcy Court does have the power to sell the subject property free and clear of liens of the appellants, and should exercise it here. The Bankruptcy Court is given the statutory authority to sell real property and derived from said statutory authority is the power to sell free and clear of liens. Such power

should be exercised when there is a substantial equity in the property.

Four, The contract between the Appellant and the Appellee Williams is subject to the Bankruptcy Act and such law is written into the contracts between the parties.

Five, The Bankruptcy Court has the right to substitute an equitable remedy of selling the subject property on a lot by lot basis in place of the remedy of foreclosure. The Court should be authorized to sell the property on a lot by lot basis where it properly finds as here, that there is a substantial equity and that a sale on a lot by lot basis is feasible. The Court should not authorize the foreclosure proceeding as a remedy where there is such a clear showing of such facts.

IV.

ARGUMENT.

1. The Referee's Findings of Fact and Conclusions of Law on Both Orders Appealed From Are Not Clearly Erroneous and Should Be Affirmed.

General Order in Bankruptcy No. 47 states that

> "unless otherwise directed in the order of reference the report of a Referee or a special master shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous."

While it is true that the findings of a Referee are not necessarily conclusive, it appears to be well established that the Referee's findings should not be disturbed unless there is overwhelming evidence that the Referee was

mistaken and that the mistake would lead to a miscarriage of justice.

The Court of Appeals for the Ninth Circuit has stated that even in the absence of any need to judge the credibility of witnesses before the Referee, the reviewing court should exercise some degree of judicial restraint for the expertise of the Referee in Bankruptcy.

See:

Olympic Finance Co. v. Thyret (9th Cir. 1964), 337 F. 2d 62;

Jue v. Bass (9th Cir. 1962), 299 F. 2d 374, 377;

Tepper v. Chichester (9th Cir. 1961), 285 F. 2d 309, 312;

Hoppe v. Rittenhouse (9th Cir. 1960), 279 F. 2d 3.

This Court of Appeals should, on the basis of the findings of fact and the record herein affirm the orders of the Court because there is no overwhelming evidence that the Referee was mistaken and because this Appellate Court should exercise some degree of judicial restraint in regard for the expertise of the Referee in Bankruptcy.

2. The Referee Found Properly That There Was Equity in the Property Under Consideration in This Appeal.

The property was appraised by the Appellee's appraiser for the total sum of $1,362,500.00 which was an average of $12,500.00 per lot [See R. T. p. 15, line 24]. The Appellants' appraiser, Taylor Dark of Marshall and

Stevens Company testified that the selling price of lots would be $13,500.00 on an average [See R. T. p. 269, lines 2-18]. Dark also testified that the fair market value of the lots if sold individually would be $1,200,-000.00 plus [See R. T. p. 359, lines 22-23]. The Appellant had no other qualified expert testimony concerning the value of the property on an individual lot basis.

The definition of fair market value acceptable to this proceeding was correctly stated by the Referee when he said:

> "The amount in cash that in all probability would be arrived at by fair negotiation between an owner willing to sell and a purchaser willing to buy, given a reasonable time to negotiate." [See R. T. p. 393, lines 2-9].

The Appellants incorrectly seek to add to the correct definition of fair market value another element to wit:

> "The fair market value of the property if purchased as a package by one person who would sell these lots at a later date at a profit." [See R. T. p. 323, lines 17-21].

The burden upon the Appellee to prove that there was an equity in this property was proved both by the Appellee's witnesses and the Appellant's expert witness, Taylor Dark.

There is no requirement that the Appellee produce evidence that the lots must be sold as a tract and would therefore produce a sum in excess of the appellant's lien.

3. The Bankruptcy Court Has the Power to Sell Property Free and Clear of the Liens or Subject to Them.

The power of the Bankruptcy Court to sell Property is set out in Section 70(f) (11 U.S.C. §110), of the Bankruptcy Act which says "real and personal property shall, when practicable, be sold subject to the approval of the Court".

The power to sell property free and clear has been derived from the said action. See *Collier on Bankruptcy,* Volume 4a, Page 1133, Section 70.97. See also *In the Matter of Bernard Altman,* 226 F. Supp. 201-1963 U.S.D./Ct. S.D.N.Y.

Also see:

Van Huffel v. Harkelrode, 284 U.S. 225, ... S. Ct. 115, 1931.

The Bankruptcy Courts have the power to sell free and clear of encumbrances but (only) where it appears that the amount of the encumbrances do not exceed the value of the property.

Louisville Bank v. Radford (1934), 295 U.S. 555 at 584.

See also:

4 Collier on Bankruptcy, Section 70.97 (2), pages 1895 to 1902 *et seq.*

It would be inequitable to allow the Appellant to rely on its argument that the property should be sold in bulk, when the property should be sold on a basis of lot by lot, and especially where as here there is a sub-

stantial equity of about $350,000.00 to protect for the creditors.

The cases and the statute have realized that where there is an equity in the property of a major amount, that the Courts should under the inherent equity rule of the Courts allow a sale free and clear of the lien of the appellants.

The findings show that the property is capable of development on an individual lot basis and there is no evidence to show that it is better handled by a sale to one person interested in a tract. There is no evidence in the record to show that the security will progressively lose its character as a tract (see page 22 of Appellant's brief), nor does the record show that the lien of the appellant is going to be transferred to another security.

The argument that each lot cannot be sold because it is subject to the full encumbrance is an argument which eliminates all possibilities of allowing the bankruptcy court to protect all parties including the rights of the secured creditors, the debtor, the receiver and the creditors. Ample protection is given to the Appellant by reason of the protection outlined by the Referee in this record, which is as follows:

> "As I told you before, you will receive the lion's share, but I am going to permit the receiver in this case to keep a small amount of what is received from those individual sales merely to cover the administrative costs of this proceeding; pos-

> sibly 5%; certainly not more than 10%, in any sale until there has been enough of this property sold to put your client in a position where the default has been cured at least." [See. R. T. p. 14, lines 8-17, hearing of November 28, 1966].

The discretionary power in the Bankruptcy Court should not be disturbed unless it appears to have been improvidently exercised, especially where the Referee represented, as he did in this case, that he believes it to be in the best interest of the estate to order a sale free of encumbrance. See *In re Miller,* 95 F. 2d 441 at page 443.

As indicated by Judge Leon Yankwich in *In re F. P. Newport Corp.* (C.D. Cal. 1954), 123 F. Supp. 95, page 98:

> ". . . and we know of no rule or practice that would warrant the court in setting aside the order of the Referee where he uses his best judgment both as to the method of sale and as to the sufficiency of the price at which the sale was made."

As the Referee pointed out in Findings of Fact 11:

> "that it is in the best interest of the general creditors that said lots be sold separately rather than on a wholesale basis."

The Referee further said in Findings of Fact 12:

> "that a sale of said lots free and clear of the lien of the Respondent Metropolitan Savings and Loan Association will in no way impair any substantive right of said respondent." [C. T. pp. 68, 69 and 70].

4. The Contract Between Parties Is Subject to the Bankruptcy Law and Such Law Is Written Into the Contracts of the Parties.

See *Jersey Island Packing Co.,* 138 Fed. 625, 9th Court of Appeals at 627,

> "It is true that the Bankruptcy Act provides that liens such as the lienholders had under the trust deeds in this case shall not be affected by bankruptcy, but that is far from saying that such lienholders may, after the commencement of proceedings in bankruptcy against the debtor, proceed to enforce their liens or contracts in the manner prescribed in the instruments which create them; and this is true whether such lien is an ordinary mortgage, or a deed of trust with provision for a street foreclosure by notice and sale. The provision of the bankruptcy act, that such a lien shall not be affected by the bankruptcy proceedings has reference only to the validity of the lienholders contract. It does not have reference to his remedy to enforce his right. The remedy may be altered without impairing the obligation of his contract, so long as an equally efficient and adequate remedy is substituted."
>
> "Every one who takes a deed of trust intended as a mortgage *takes it subject to the contingency that proceedings in bankruptcy against his mortgagor may deprive him of the specific remedy which is provided for in his contract.* (Emphasis added).

Citing the *Jersey Island Packing Co.*, language is *United States National Bank v. Pamp,* 83 F. 2d at 503.

5. The Bankruptcy Court May Change the Remedy Under a Contract if an Equally Adequate Remedy Is Available.

A substituted remedy should be allowed where the Court finds that the best way to sell property is on an individual lot by lot basis. The Referee in the instant case found this as a finding of fact and there was no evidence to the contrary presented by the Appellant. Even the expert witness for the Appellant testified as to the greater value of the property if it was sold on a lot by lot basis.

Although the bankruptcy act expressly preserves the rights of secured creditors, the jurisdiction and method of determining such rights is procedural. The Court of Bankruptcy has adequate equity powers to adjudicate all liens and the method of their liquidation. See *Redmond v. United Funds Management Corp.* (C/A-8th, 1944), 144 F. 2d 158.

Also see *Allebach v. Thomas,* 16 F. 2d 853 at 855, Court of Appeals, 4th Circuit 1927:

> "The theory of the Appellants and Petitioners for review is that they have been deprived by the action of the Court of some contractual right in respect to their debts, and the security taken for payment of the same. This, however, is an entire misconception of the effect of the Bankruptcy Law, which in plain terms provides that the bankruptcy proceedings shall not affect the validity of the lien; *but it nowhere says that this fact shall in any manner affect the remedy to enforce the lienor's rights. The remedy may be altered, without impairing the obligations of the contract, so long as an equally adequate remedy is afforded.*" (Emphasis added).

See also at page 855:

> "Just to whom shall be delegated the power to sell the property depends upon many considerations. Preferentially, as between the Bankrupt's Trustee and the Trustee (under) the deeds of trust . . . where an equity is believed to exist, the choice would be with the bankrupt's trustee, as he is assumed to be impartial, and representative of a bankrupt, lienors, and the creditors, alike; whereas, the trustees in deeds of trust are alone interested in the protection of their beneficiaries . . . this entire subject is within the discretion of the bankruptcy court . . . and [should use the one method] best suited to yield . . . the best results."

The case of *Wright v. Union Central Insurance Co.,* 304 U.S. 503, 82 L. Ed. 1490, U.S. Supreme Court, 1938 at page 515, stated:

> "The mortgage contract was made subject to constitutional power in Congress to legislate on the subject of bankruptcy. Implied by this was written into the contract between petitioner and respondent."

and at page 517,

> "Bankruptcy proceedings constantly modify and affect the property rights established by state law."

In the case of *Continental Illinois National Bank v. R.I. RR,* 294 U.S. 648, 79 L. Ed. 1110, U.S. Supreme Court allowed the suspension of the enforcement of lien in reorganization cases, reviewing all of the cases granting such relief.

The remedies substituted by the Referee for Appellants remedy of foreclosure was found to be adequate and efficient. The Referee's decision should not be disturbed upon appeal, as the Referee found that there is a substantial equity in this property. The Bankruptcy Court having the power to order a sale free and clear of liens, an interference with such authority by the argument of the Appellant that the property should be sold in bulk would produce an inequitable result.

There is no evidence before the Court in the record that the sale free and clear of the Appellant's lien will produce anything other than a full payment to the Appellants. The Referee desired the sale to produce proceeds which would benefit the Appellant. The Appellants argument that the property would progressively lose its character as a tract, if true, and if a part of this record, could be used as an argument on behalf of this Appellee to the effect that as property is sold the Appellant's interest in the balance of the tract would be increased. The Appellee then would be in the position ascribed to the Appellants by the opening brief of the Appellants.

The argument raised by the Appellant concerning the alleged injury to the Appellant is not in this record. However, assuming that it is true and assuming it to be in this record, a sale free and clear on a lot by lot basis will improve the position of the Appellant and eliminate any alleged damages.

V.

CONCLUSION.

The Court having statutory power to sell property and deriving the power to sell free and clear, from such authority, the power should be authorized when there is a clear, uncontroverted finding of a substantial equity. The Bankruptcy Court should be allowed to substitute the remedy of sale of the lots in the subject property on an individual basis free and clear of the Appellant's lien subject to the payment to the appellant.

Respectfully submitted,

GOLDMAN, GOLDMAN & ARNOLD,
By LEONARD A. GOLDMAN,
Attorneys for Appellee
A. J. Bumb, Receiver.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

LEONARD A. GOLDMAN